

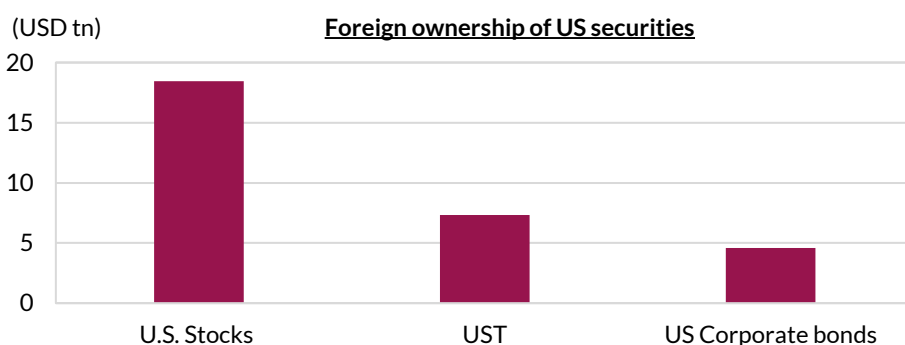
More tools for the President, further weakness in the USD?

Section 899 of the Big Beautiful Bill passed by the House allows for raising income tax and withholding tax rates by 5-20% on investors from a “discriminatory country”. The EU appears to be the principal target, given definition of “unfair foreign taxes”, and ongoing disputes on digital services taxes: even President Biden had tried to get such provisions passed. However, this adds to the ammunition available with the President in his trade negotiations, expanding the tariff war to capital assets. The EU, as the largest foreign holder of US assets, is the most at risk, but it can be used elsewhere as well. Deterred foreign investment would raise US cost of capital (e.g., yields), and weaken the USD.

May 27, 2025

Dollar Dominance

Exhibit 1 - Foreigners hold ~30% of US equities, USTs, and credit outstanding



Source: Fed, Axis Bank Research

“Big Beautiful Bill” provides remedies against “unfair foreign taxes”

Section 899 of the Big Beautiful Bill that was passed by the House (not yet by the Senate) allows for an increase in federal income tax and withholding tax rates on investors that are from a “discriminatory country”. As the bill defines this as a country that imposes “unfair foreign taxes”, defined as “undertaxed profits rule”, “digital services tax” and “diverted profits taxes” along with other taxes as determined by the US Treasury department (details [link](#)), it seems to be directed towards the EU, in our view. With ~USD116bn in revenue expected over a 10-year period, boosting tax revenues is unlikely to be the primary purpose.

Provides tools for a broader tax negotiation specifically against Europe

This bill provides more ammunition to the US President, who so far had freedom mostly on import tariffs. It is a retaliatory effort largely in response to several issues at play in US-EU tax negotiations. Some of these provisions were part of a bill that President Biden wanted passed as well but was unable to. The background is that historically, international taxing rights are mostly given to the country where the value of a product is created. However, with digital products, countries in Europe have moved to taxing where customers/users are located: Pillar One of the two-pillar approach ([link](#)). The US sees this as discriminatory against US tech companies which are the most affected by Digital Services Taxes.

But enables broader action, and can drive USD weakness

While the immediate motivation appears to be tax negotiation, the enabling provisions expand the trade war to capital assets as well. A 5-20% withholding tax as proposed in the current draft is likely to deter foreign holders: their unwillingness to invest in the US would be bearish for broader markets, raise funding costs in the US (higher yields), and accelerate the decline in the USD. Due to high fiscal deficits, US investments exceed domestic savings ([link](#)), making it dependent on foreign investors. The EU is the largest foreign holder of US assets: >35% of foreign holdings of USTs and corporate bonds (Fig 2, 4), and >45% for stocks (Fig 3), and is likely to be the most at risk. Exchange rates remain a very important channel to adjust macroeconomic imbalances ([link](#)).

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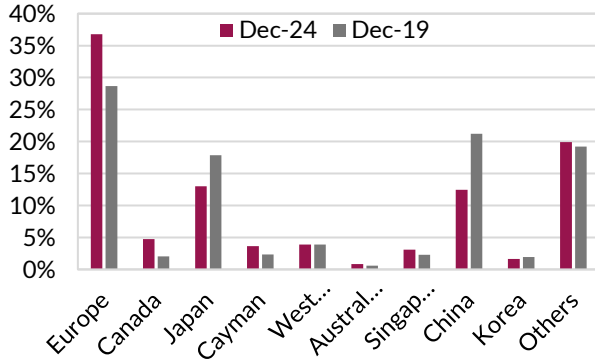
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Exhibit 2 - Europeans are >35% of foreign holdings of USTs

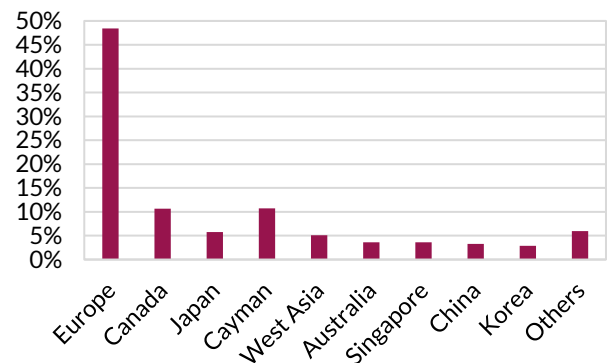
Composition of foreign residents' holdings of U.S. Long-term Treasury Securities



Source: CEIC, Axis Bank Research

Exhibit 3 - 48% of foreign holdings of US stocks with Europe

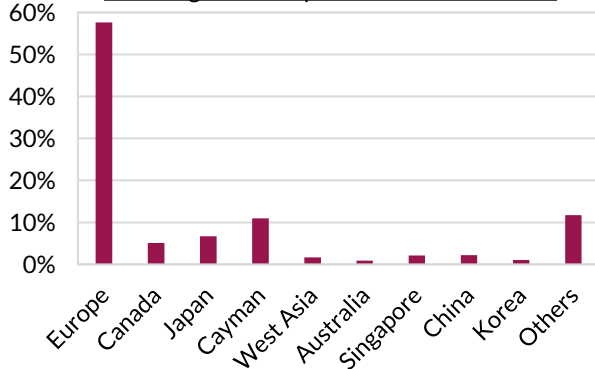
Composition of foreign residents' holdings of U.S. Corporate Stocks



Source: CEIC, Axis Bank Research

Exhibit 4 - EU holds >50% of long-term corporate bonds...

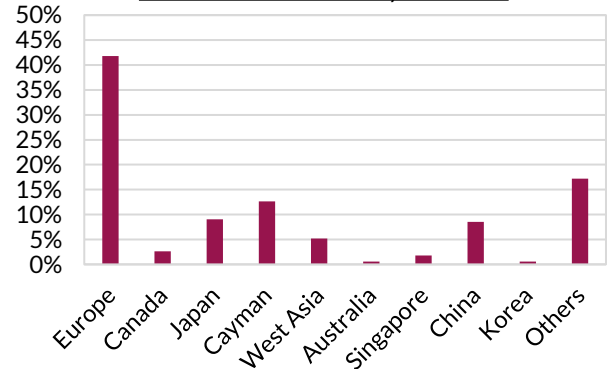
Composition of foreign residents' holdings of U.S. Long-term Corporate and Other Bonds



Source: CEIC, Axis Bank Research

Exhibit 5 - ...and >40% of short-term USTs

Composition of foreign residents' holdings of U.S. Short-term Treasury Securities



Source: CEIC, Axis Bank Research

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